No. 16050

United States Court of Appeals

For the Ninth Circuit

McNEIL CONSTRUCTION COMPANY,
a corporation,

Appellant,

v.

THE LIVINGSTON STATE BANK,
a corporation,

Appellee.

Appellee's Brief

Appeal from the United States District Court for the District of Montana

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Plaintiff has appealed from an order of the district court dismissing its amended complaint. It seeks by this appeal not only to review the action of the district court in dismissing the amended complaint, but also to review the orders of the court which were entered upon the issues presented under the original complaint, and which imposed conditions voluntarily ac-

cepted by the plaintiff. We contend that the prior orders are not properly before this Court for review, and to demonstrate that contention we wish to recount briefly the developments leading up to the dismissal of the amended complaint.

On May 1, 1957, appellant filed its complaint, seeking to recover from the appellee for damages it claimed to have sustained by reason of the alleged payment of forged payroll checks drawn on plaintiff's account. (R. 3-6).

On May 28, 1957, defendant filed motions to dismiss and to add the Seaboard Surety Company as a party plaintiff. (R. 6-10).

On May 29, 1957, plaintiff filed requests for admissions, which were responded to in due course by the defendant. (R. 10-24).

On August 19, 1957, plaintiff filed its motion for summary judgment and supporting affidavits. A counter-affidavit was later filed by the defendant, and thereafter supplementary affidavits were filed by the plaintiff. (R. 24-72).

On December 4, 1957, the Honorable W. D. Murray entered an order (a) denying defendant's motion to add Seaboard Surety as a party plaintiff, (b) denying plaintiff's motion for summary judgment, and (c) granting the plaintiff twenty days within which to file an amended complaint, otherwise summary judgment to be entered in favor of the defendant. The reasons for Judge Murray's decision were fully expressed by him in the order, which appears in the record at pages 74 to 84, inclusive. The court held that (a) Mc-

Neil Construction Company was not the proper party plaintiff because its loss had been paid in full by Seaboard Surety Company (R. 76-80); and (b) the complaint did not state a claim upon which either McNeil or Seaboard could recover, and for this reason summary judgment should be entered in favor of the defendant. (R. 80-84). However, in the interests of justice (R. 84), the court granted McNeil an opportunity to amend its complaint, stating that it was perhaps possible for plaintiff to state a claim, based on the doctrine of equitable subrogation, and on the theory that it was the trustee of an express trust.

On December 9, 1957, and within the twenty day period allowed by the court, the plaintiff filed its amended complaint, thus avoiding the entry of summary judgment (R. 85-88).

On December 19, 1957, defendant filed its motion to dismiss or, in the alternative, to require the joinder of Seaboard Surety Company as party plaintiff. (R. 88, 89).

On April 11, 1958, Judge Murray entered an order dismissing plaintiff's amended complaint, holding (a) that the amended complaint did not state a claim upon which relief could be granted, and (b) that the amended complaint revealed that plaintiff was not the trustee of an express trust. (R. 89-91).

On May 9, 1958, plaintiff filed its notice of appeal, stating that it was appealing from the last mentioned order, "and from each and every interlocutory order reviewable by the Court of Appeals which was entered

prior to the entry of the final Order hereinabove more specifically referred to."

I. APPELLANT'S SPECIFICATIONS OF ERROR NUMBERED 1 AND 3 ARE NOT PROPERLY BEFORE THIS COURT FOR REVIEW.

Appellant's specifications of error are set forth in its brief at page 15. They are:

> "1. The Court erred in dismissing the original Complaint.
>
> 2. The Court erred in dismissing the Amended Complaint.
>
> 3. The Court erred in denying plaintiff's Motion for Summary Judgment."

It will be noted that specifications numbered 1 and 3 are in respect of the order of court dated December 4, 1957, granting plaintiff twenty days to file an amended complaint as an alternative to the entry of summary judgment in favor of the defendant. The order gave plaintiff a clear choice as to the course it could pursue. Plaintiff could have obtained a review of the decisions rendered in that order by appealing from a judgment entered thereon after lapse of the twenty day period. Instead plaintiff chose to accept the conditions imposed by that order, and filed an amended complaint within the prescribed period. This constituted a positive election to go forward under the rules laid down by the court, and an absolute waiver of the right to a review of the order.

The general rule is stated in 4 C. J. S., *Appeal and Error*, Section 212, at page 617, as follows:

> "A party who voluntarily acquiesces in, ratifies, or recognizes the validity of, a judgment,

> order, or decree against him, or otherwise takes a position which is inconsistent with the right to appeal therefrom, thereby impliedly waives, or is estopped to assert, his right to have such judgment, order, or decree reviewed by an appellate court; and this rule has been held to apply where the acquiescence or ratification was either partial or in toto. The 'acquiescence' which prohibits an appeal is an acquiescence in a judgment, decree, or order, which commands something to be done or given, and consequently, acquiescence occurs when the thing is done or given. In order to be a bar of the right of appeal on the ground of acquiescence, the judgment or decree must have been rendered and entered, and the acts relied on, as a waiver or estoppel on such ground, must be such as to clearly and unmistakably show an inconsistent course of conduct or an unconditional, voluntary, and absolute acquiescence, with the intent, as has been held, to ratify or confirm the judgment as rendered, and to acquiesce and abandon the right of appeal."

A more specific application of the principle may be found in the same section, at page 621:

> "As a general rule, if a trial court imposes terms as the condition on which a continuance or an amendment will be allowed, or a default judgment will be opened, or on which any other order will be granted or any other thing done or not done, and the party on whom the terms are imposed accepts them, he will be deemed to have acquiesced in the ruling and cannot afterward question its validity in the appellate court."

In re Smith (9 Cir. 1934), 71 F. 2d 378, involved an appeal from an order of the district court adjudicating the rights of a bankrupt in the estate of a deceased person. The bankrupt also appealed from an order requiring her to execute and deliver to the trustee a stip-

ulation of dismissal of another action pending in another court. The court dismissed the last mentioned appeal for the following reasons, stated in its opinion at page 381:

> "Appellee contends that this appeal should be dismissed because no substantial argument has been made to show why the order was erroneous and because the appeal had become moot by reason of compliance with the order complained of. Compliance, as shown by an exhibit, is not denied. This appeal must therefore be dismissed. American Book Co. v. Kansas (1904) 193 U.S. 49, 24 S. Ct. 394, 48 L. Ed. 613."

Bennell Realty Co. vs. E. G. Shinner & Co. (7 Cir. 1937), 87 F. 2d 824, was an appeal from a decree based on an appraiser's award. A prior appraisal had been set aside by the court, by interlocutory decree granting to the parties the opportunity of designating new appraisers and obtaining a re-appraisement. Appellant claimed that the court erred in setting aside the first appraisement. It was held that the appeal was moot because appellant had voluntarily accepted the provisions of the interlocutory decree by designating new appraisers and proceeding with the re-appraisal. The court said, page 826:

> "We are convinced that appellant by proceeding under the voluntary provisions of the third paragraph of the interlocutory decree precluded itself from relying upon its objections and exceptions to the court's ruling in setting aside the first appraisement and permitting another. There was nothing compulsory in the third paragraph of the interlocutory decree. It amounted to nothing more than a permissive gesture of the court, looking to an amicable settlement of the parties' differences. They both accepted the benefits of that suggestion,

among which was the chance of each party getting a re-appraisement more favorable to itself, and also the avoidance of delay and expense in further pursuing the mandatory course which the court had ordered in case the provisions of the voluntary program should not be followed. When they voluntarily accepted this chance, they took it with its burdens as well as its benefits, and the procedure was utterly inconsistent with appellant's intention to further pursue the court's alleged error in setting aside the first appraisement."

This principle was adherred to by the Montana supreme court in *Harrington vs. Butte, Anaconda & Pacific R. Co.* (1909), 39 Mont. 22, 101 Pac. 149. Mr. Chief Justice Brantly wrote the opinion of the court, portions of which are hereinafter quoted:

"The language of the plaintiff's acceptance of the condition is: 'And this plaintiff * * * does hereby remit all damages in excess of,' etc. The reservation, expressed in the form of a condition, is in fact no condition, but the reservation of an exception expressive of an intention to question the power of the court to make the order at all. If he had this right to question the court's power, he had it without the reservation; but he could not comply with the condition imposed and still say the court had no power to impose it. He could not say, 'I accept the advantage offered me of avoiding a new trial, but I will proceed to test the question whether the court had the power to grant me this advantage; and if I find that the power does not exist, I will be the gainer to the amount of $3,500, while my adversary, if he chooses to submit to the order, becomes the loser to this amount.' The only course open to him was to waive all irregularity in the proceedings on the motion and comply with the order, or to refuse to comply at all. He would then have been in a position to question the regularity of the proceedings on the mo-

tion anterior to the order. As it is, he cannot be heard to say that the order in his favor made so by his own act of acceptance of its conditions, is not binding upon him, or that he is aggrieved by it. Taking either view of the case, the plaintiff's contentions are without merit. If the order did not by his act become absolute, the appeal is premature, and defendant's motion to dismiss it must be sustained. If it did become absolute, the order is in his favor, made so virtually by his consent, and hence he cannot say that he has been aggrieved by it. The situation is anomalous, to say the least, and not without difficulty; but we are not disposed to adopt a view which recognizes a right in litigants to juggle with a court, as plaintiff has shown a disposition to do in this case. We hold that by filing his acceptance, couched in the terms it is, the plaintiff waived any irregularity in the proceedings on the motion, and that, having thereby avoided another trial, he has no grievance which he may submit to this court, The appeal is therefore dismissed on this ground."

The comments made in the foregoing cases are equally applicable to this case. Appellant complains, on page 13 of its brief, that the court's action put the plaintiff in a precarious position, and that plaintiff could not risk an appeal from the former order because it would have become a judgment on the merits if this Court should affirm. But this is no reason to permit the plaintiff to accept the fruits of the former order without being bound by its conditions. As was stated by the United States Supreme Court in *American Book Co. vs. Kansas* (1904), 193 U.S. 49 (cited by this Court in *In Re Smith* (9 Cir. 1934), 71 F. 2d 378, *supra*):

"The judgment has been complied with. It makes no difference that plaintiff in error 'felt coerced' into compliance. A judgment usually has

> a coercive effect, and necessarily presents to the party against whom it is rendered the consideration whether it is better to comply or continue the litigation. After compliance there is nothing to litigate."

II. APPELLANT IS NOT THE REAL PARTY IN INTEREST.

(a) This Court Should Defer to the Trial Judge's Interpretation of Montana Law.

The district court, by its first order dated December 4, 1957, (R. 74), held that the plaintiff, McNeil Construction Company, was not the real party in interest because its loss had been paid in full by the Seaboard Surety Company. (In addition the court held that the complaint failed to state a claim upon which either McNeil or Seaboard could recover. This point will be discussed at another portion of this brief.) The court gave plaintiff an opportunity to amend its complaint, stating that it was perhaps possible for the plaintiff to maintain this action upon the theory that it was the trustee of an express trust. By its second order, dated April 10, 1958, (R. 89), the court decided that the complaint revealed that McNeil was not the trustee of an express trust, and, in effect, held that McNeil was not, under any conceivable theory, the real party in interest.

Plaintiff relies on the document entitled "Loan Receipt", attached to its amended complaint, marked "Exhibit B", and appearing in the record at page 37. It maintains that McNeil has simply received a "loan" from the surety company and that the document referred to creates an express trust in favor of the Sea-

board Surety Company. The district court rejected both contentions.

The reasons for the court's decision that plaintiff was not the real party in interest are stated in its first order, appearing in the record at page 74. We quote certain portions thereof below:

> "Defendant contends that since the money was received by McNeil Construction Company and the loan receipt agreement was executed in California, California law should control, and that therefore under the case of American Alliance Insurance Company vs. Capital National Bank, 171 Pac. (2d) 449, the money was received by McNeil Construction Company from Seaboard Surety Company as a payment rather than as a loan. The so-called loan receipt transaction has not been considered by the Supreme Court of Montana and the plaintiff insists that because the transaction, which gave rise to the loan receipt agreement, occurred in the State of Montana, Montana law would govern, and this being a diversity case that this Court should decide that if the question were presented to the Montana Supreme Court, it would uphold the loan receipt transaction as a loan.
>
> In the view that the Court takes, it is unimportant whether California law or Montana law applies because the Court believes if the question were presented to the Montana Supreme Court it would follow the same reasoning that the California court adopted, and hold the transaction constituted 'payment' rather than a 'loan'."

Then, after considering the case of *Luckenbach vs. W. J. McCahan Sugar Refining Company* (1918), 248 U.S. 139, and the case of *Yezek vs. Delaware L. & W. R. Co.* (1941), 176 Misc. 553, 28 N.Y.S. 2d 35, the court went on to state:

> "The Luckenbach case also held that whether

such a transaction constitutes a payment or a loan is a matter of intention of the parties. In this case, the only evidence of the parties' intention to engage in a loan transaction is the loan receipt. On the other hand, the evidence is that the money was paid by Seaboard to McNeil in the exact amount of McNeil's loss and was paid in response to a claim filed by McNeil under the surety bond, the terms of which required Seaboard to pay McNeil the amount of the loss rather than make McNeil a loan. No interest was charged and the so-called loan was repayable only in the event and to the extent of any net recovery which McNeil might make against third parties. Certainly McNeil does not consider itself a debtor to Seaboard as a result of the so-called loan, nor would Seaboard, in a suit by McNeil under the bond, hesitate to claim the so-called loan as a discharge of its obligation under the bond. Viewing the so-called loan transaction in the light of all of the evidence from which the true intention of the parties can be gleaned, the Court feels that the Montana Supreme Court would have little difficulty in holding that the money paid McNeil by Seaboard constituted 'payment' of its obligation under the surety bond, and not a 'loan', and this Court so holds.

Having been made whole by the payment of its loss by the surety company, under the provisions of Rule 17(a) of the Federal Rules of Civil Procedure and the case of U. S. vs. Aetna Cas. & Sur. Co., 388 U.S. 366, McNeil Construction Company is not the proper plaintiff in this action, not being the real party in interest. It is equally clear under the docrtine of U. S. vs. Aetna, supra, that Seaboard Surety Company, having paid the loss is the real party in interest, if in the circumstances of the case, it is entitled to be subrogated to McNeil's claim against the bank."

From the above, it can be seen that the district court made a determination that the Montana Supreme

Court, if the question were presented to it, would hold that the transaction involved in this case constituted "payment" rather than a "loan". In doing so, it recognized the rule, which is conceded by both parties, that the effect and validity of the loan receipt transaction upon the parties thereto is a question of substantive law. *Rosenfeld vs. Continental Building Operating Company* (D.C. Mo. 1955), 135 F. Supp. 465. The appellant asks this Court to reverse the decision of the district court, based upon its interpretation of the substantive law of Montana. Counsel would have this Court hold that Judge Murray erred in deciding that the Montana supreme court would view this transaction as constituting "payment" rather than a "loan". He wants the Court to substitute its judgment for the considered judgment of the district court on a matter which is concededly an open question in Montana, and upon which there is diversity of opinion elsewhere.

This Court has recently held that it will defer to the trial judge's interpretation of state law in such circumstances and will not reject any such interpretation unless it is manifestly contrary to the decisions of the state court. In *People of the State of California vs. United States* (9 Cir. 1956), 235 F. 2d 647, the Court accepted the views of the trial judge, sitting in California, on matters of California water law, stating as follows in the opinion at page 653:

> "Here the United States 'claims only such rights to the use of water as it acquired when it purchased Rancho Santa Margarita, together with any rights which it may have gained by prescription or use or both since' that time. Inasmuch as

> the rights at the date of acquisition depend upon the law of the state, this Court defers to the interpretation of the able trial judge, himself a lawyer of the state of long standing, acquainted with the imponderables and implications inherent in the pronouncement of the courts of the state. This Court will not reject any such interpretation unless convinced that it be manifestly contrary to the holdings of the local tribunals."

And in *Bower vs. Bower* (9 Cir. 1958), 255 F. 2d 618, this Court, in a per curiam opinion and for the same reason, declined to overrule a decision of District Judge Jameson as to how the Montana supreme court would decide the validity of a property settlement agreement.

A similar practice has long been observed by the United States Supreme Court. For example, in *Huddleston vs. Dwyer* (1944), 322 U. S. 232, it was stated in a per curiam opinion at page 237:

> "The decision of the highest court of a state on matters of state law are in general conclusive upon us, and ordinarily we accept and therefore do not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts, cf. Ruhlin v. New York Life Ins., Co., supra. When we are called upon to decide them, the expression of the views of the judges of those courts, who are familiar with the intricacies and trends of local law and practice, if not indispensable, is at least a highly desirable and important aid to our determination of state law questions. This Court will not ordinarily decide them without that aid where they may conveniently first be decided by the court whose judgment we are called upon to review. See, e. g., Ruhlin v. New York Life Ins. Co., supra; Rosenthal v. New York Life Ins. Co., 304 U.S. 264, 264, 58 S. Ct. 874, 875, 82 L. Ed.

> 1330; West v. A. T. & T. Co., 311 U. S. 223, 241, 61 S. Ct. 179, 185, 85 L. Ed. 139, 132 A.L.R. 956; Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 497, 61 S. Ct. 1020, 1022, 85 L. Ed. 1477; Meredith v. Winter Haven, supra."

The courts of appeals in other circuits have applied similar rules in reviewing the decisions of district courts as to interpretations of local law. In *Kimble vs. Willey* (8 Cir. 1953), 204 F. 2d 238, the following comments were made (opinion, page 243):

> "We conclude that the decision of the District Court is supported by available authority. But even in the absence of such authority, this court will not in this case substitute its judgment for that of the District Court.
>
> 'This Court has repeatedly ruled that it will accept the considered views of a District Judge as to doubtful questions of local law. Many of the cases in this Court and the Supreme Court which support that rule will be found in the case of Buder v. Becker, 8 Cir., 185 F.2d 311, 315-316. In Western Casualty & Surety Co. v. Coleman, 8 Cir., 186 F.2d 40, 43, we said: 'The burden of demonstrating error is upon the Casualty Company. In a case controlled by local law, that burden is a peculiarly heavy one. This Court is not an appellate court of the State of Missouri and establishes no rules of law for that State. We have repeatedly said that, in reviewing doubtful questions of local law, we would not adopt views contrary to those of the trial judge unless convinced of error, and that all that this Court reasonably can be expected to do in such cases is to see that the determination of the trial court is not induced by a clear misconception or misapplication of the local law. Russell v. Turner, 8 Cir., 148 F.2d 562, 564; Buder v. Becker, 8 Cir., 185 F.2d 311, 315, and cases cited. If a federal district judge has reached a permissible conclusion upon a question

> of local law, we will not reverse, even though we may think the law should be otherwise.' National Bellas Hess, Inc. v. Kalis, 8 Cir., 191 F.2d 739, 741."

In this case the trial judge, a distinguished member of the bar of the state of Montana, made an interpretation of the substantive law of Montana when he held that the Montana supreme court would view this "loan receipt" transaction as full payment of the loss. His reasons for so concluding are fully set forth in the order dated December 4th, and were based upon an absence of authoritative decisions in Montana and a conflict of authority elsewhere. The appellant has failed to demonstrate that this interpretation of the local law is "manifestly contrary" to the Montana decisions, and therefore, under the rule adopted by this Court, that decision should stand.

(b) The District Court Was Correct in its Determination that Plaintiff Was Not the Real Party in Interest.

Even if the decision of Judge Murray on the question under consideration were to be subject to the independent review of this Court, we submit that it was eminently correct and should be upheld.

The cases uniformly hold that where plaintiff's loss has been paid in full by insurance, the insurer is the real party in interest within the meaning of Rule 17 (a), Federal Rules of Civil Procedure. *United States vs. Aetna Casualty & Surety Co.* (1949), 338 U.S. 366, was a case involving partial payment of a plaintiff's claim, and the Court, speaking through Mr. Chief Justice Vinson, interpreted Rule 17(a) as follows (opinion, page 380):

> "Rule 17(a) of the Federal Rules of Civil Procedure, 28 U.S.C.A., which were specifically made applicable to Tort Claims litigation, provides that 'Every action shall be prosecuted in the name of the real party in interest,' and of course an insurer-subrogee, who has substantive equitable rights, qualifies as such. If the subrogee has paid an entire loss suffered by the insured, it is the only real party in interest and must sue in its own name. 3 Moore, Federal Practice (2d Ed.) p. 1339. If it has paid only part of the loss, both the insured and insurer (and other insurers, if any, who have also paid portions of the loss) have substantive rights against the tortfeasor which qualify them as real parties in interest."

The *Aetna Casualty Company* case is binding upon all federal courts in respect to this question, since Rule 17(a) involves a matter of procedure. Consequently, if the fact of payment were conceded by plaintiff in this case, the defendant would prevail as a matter of law. However, the plaintiff relied upon the fact that the transaction between Seaboard Surety Company and the plaintiff was in the form of a Loan Receipt. This presented a question which has been considered often by both federal and state courts. This has resulted in a conflict in the decisions, some courts holding that such transactions do not constitute payment, and others reaching the opposite conclusion.

Loan receipts were developed as a means of preventing carriers and bailees from inequitably shifting the burden of loss that was rightfully theirs on to the shoulders of the shipper's or bailor's insurance carrier. They have been used by insurance companies in such situations for many decades, and from time to time in past years the courts have had occasion to pass upon

the legal effect of such transactions. In most cases the transactions, used for the purpose referred to, were held to be valid arrangements and were generally upheld as "loans". The Supreme Court of the United States passed upon this type of an arrangement in the case of *Luckenbach vs. W. J. McCahan Sugar Refining Co.* (1918), 248 U.S. 139. The case involved the question of a carrier's liability to a cargo owner for damages resulting from the unseaworthiness of the vessel. The carrier claimed that it was not liable because the cargo owner had already been compensated by insurance and that it was entitled to the benefit of the insurance under the clause in the bill of lading which provided that in case of a loss for which the carrier shall be liable it should have "the full benefit of any insurance that may have been effected upon or on account of such goods". The Court held that the insurer had not made a payment but had advanced a loan to the cargo owner and that the loan receipt was valid evidence of such transaction. Justice Brandeis stated in the opinion:

> "Whether the transfer of money or other thing shall operate as a payment, is ordinarily a matter which is determined by the intention of the parties to the transaction. Compare The Kimball, 3 Wall. 37, 44, 18 L.Ed. 50. The insurer could not have been obliged to pay until the condition of their liability—i.e. non-liability of the carrier—had been established. The shipper could not have been obliged to surrender to the insurers the conduct of the litigation against the carrier, until the insurers had paid. In consideration of securing then the right to conduct the litigation, the insurers made the advances. It is creditable to the

> ingenuity of business men that an arrangement should have been devised which is consonant both with the needs of commerce and the demands of justice."

Since the *Luckenbach* decision, the loan receipt has become a popular device, and there now exists a conflict in the decisions as to whether, under ordinary circumstances, such transactions constitute payment. Many courts, perhaps the majority, have cited the *Luckenbach* case as authority for the proposition that a loan receipt transaction does not constitute payment and that, accordingly, the insured remains the real party in interest.[1] However, as the district court pointed out in its opinion (R. 78) the *Luckenbach* case is clearly distinguishable from this case. In the *Luckenbach* case the insurance company's liability was contingent upon the non-liability of the carrier, whereas in this case the surety company's liability is absolute. As stated by the district court, "in the Luckenbach case, the insurance company was not obligated to pay until it was first established that the carrier was not liable for the damages. The insurance company advanced the amount of the loss as a loan in consideration of the owner of the cargo turning over to it the direction and control of the owner's suit to establish the carrier's liability. The court upheld the arrangement as a proper one to protect the insurance company's interest in the suit, to

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1 See for example: **The Plow City** (3 Cir. 1941), 122 F.2d 816; **Merriman vs. Cities Service Co.** (D.C.S.D. Mo. 1951), 11 F.R.D. 165; **Williams vs. Union Pacific Railroad Co.** (D.C. Neb. 1950), 94 F. Supp. 174; **Blair vs. Espeland** (Minn. 1950), 43 N.W. 2d 274; **Shiman Bros. & Co. vs. Nebraska National Hotel Co.** (1943), 143 Neb. 404, 9 N.W. 2d 807; **State Farm Mutual Auto Insurance Co. vs. Hall** (1942), 292 Ky. 22, 165 S. W. 2d 838; and **Phillips vs. Clifton Manufacturing Co.** (1944), 204 S.C. 496, 30 S.E. 2d 146.

establish the carrier's liability and to insure prompt payment to the insured of the loss".

The district court then went on to quote from *Yezek vs. Delaware L. & W. R. Co.* (1941), 176 Misc. 553, 28 N.Y.S. 2d 35, *supra*, to illustrate the distinction:

> "The insurer's liability to the insured is absolute when the loss occurs. No shipper or other third party is involved. The insured is entitled to prompt payment without resort to a loan. The transaction is held to be a payment. * * * It was 'payment without regard to its form'. The socalled loan was a fiction, a subterfuge unnecessary either to protect the insurer or to secure prompt payment to the insured."

In *Rosenfeld vs. Continental Building Operating Company,* (D.C. Mo. 1955), 135 F. Supp. 465, the district court had before it a similar problem of determining the substantive state law on this question. We quote from the opinion:

> "Rule 17(a) requires simply that 'Every action shall be prosecuted in the name of the real party in interest'. That means that the one who seeks relief upon a claim must, legally, or equitably, own the claim under the substantive law of the state, United States v. Allbaugh, D.C. Neb., 83 F. Supp. 109; Carlson v. Glenn L. Martin Co., D. C. Ohio, 103 F. Supp. 153; Capo v. C-O Two Fire Equipment Co., D.C.N.J., 93 F. Supp. 4; DuRoure v. Alvord, D.C. N.Y., 120 F. Supp. 166, and Koepp v. Northwest Freight Lines, D.C. Minn., 10 F.R.D. 524, and, therefore, in determining who is the real party in interest under Rule 17(a) the Court must first ascertain who has the substantive right of action under the controlling substantive state law, American Fidelity & Casualty Co. v. All-American Bus Lines, 10 Cir., 179 F. 2d 7, 10; McWhirter v. Otis Elevator Co., D.C.S.C., 40 F.Supp. 11, and

Montgomery Ward & Co. v. Callahan, 10 Cir., 127 F. 2d 32, 36."

The court then proceeded to apply the substantive law of New York, the state where the loan receipt had been executed and the insured had received payment. Its decision was based upon the New York law to the effect that loan receipt transactions were not valid unless authorized in the particular insurance policy, and the court held that the loan receipt transaction constituted payment. In that respect the following comment was made:

> "I am, therefore, of the opinion that the substantive law of New York upon the question, as determined by the last decisions of its highest court above cited, is that if the policy contains provisions authorizing the insurer to settle its liabilities with the insured by a loan, the loan is not payment, but otherwise it is payment. Here, there is no provision in the policy authorizing the insurer to settle its liabilities by a loan, and, therefore, under the controlling law of New York, the 'loan' was payment, and, under the holding of the Supreme Court in United States v. Aetna Casualty & Surety Co., 338 U.S. 366, 70 S.Ct. 207, 94 L.Ed. 171, the insurer is the real party in interest and must prosecute the suit in its own name."

We had contended before the district court that, since the loan receipt in question here was executed in California, California law applied and that the case was controlled by *American Alliance Insurance Co. vs. Capital National Bank* (1946), 75 Cal. App. 2d 787, 171 P. 2d 449.[2] The plaintiff had contended that Montana law was applicable. The court obviated the ne-

2 For decisions of other state courts to the same effect, see: **Cleveland Paint & Color Co. vs. Bower Mfg. Co.** (1951), 155 Ohio St. 17, 97 N.E. 2d 545; and **McKenzie vs. North River Insurance Co.** (1951), 257 Ala. 265, 58 S.2d 581.

cessity of deciding this point by concluding that the Montana supreme court would view the transaction as "payment" rather than as a "loan".

(c) Plaintiff May Not Maintain the Action as Trustee of an Express Trust

In its first order, the district court left open the question whether the plaintiff could maintain an action in its own name, as trustee of an express trust, on behalf of Seaboard Surety Company. The theory adopted by the plaintiff in its amended complaint, and rejected by the district court in its second order, is that the loan receipt constituted an express trust, entitling plaintiff to sue in its own name under the provisions of Rule 17(a), Federal Rules of Civil Procedure.

The rule announced in the case of *United States vs. Aetna Casualty & Surety Co.* (1949), 338 U.S. 366, precludes the adoption of the trustee theory, once it is established that the insured has been paid in full. That case unequivocally held that a subrogee which has paid an entire loss must sue in its own name. To our knowledge there have been no federal cases involving full payment which have deviated from the rule announced in that case. The case of *Dixey vs. Federal Compress & Warehouse Co.* (8 Cir. 1942), 132 F. 2d 275, relied upon by the plaintiff, did not constitute a deviation from the rule because the court in that case held that the plaintiff's loss had not been paid. On page 279, the opinion states:

> "The Supreme Court of Tennessee has taken the view that a transaction such as disclosed by the loan receipts in the instant case, is not in fact

> a loan but must be considered as payment. But we think the weight of authority sustains the holding that in the absence of evidence to the contrary such adjustments constitute loans and not payments."

But where, as here, the insured has been fully paid, the rule of *United States vs. Aetna Casualty & Surety Co.* (1949), 338 U.S. 366, *supra*, comes into play and precludes the trustee theory. This, in effect, was the decision in *Sunray Oil Corporation vs. Allbritton* (5 Cir. 1951), 187 F. 2d 475, which held that plaintiff could not recover on behalf of his workmen's compensation carrier. We quote from the opinion at page 477:

> "Finding no reversible error in the record, we, therefore, affirm the judgment, except as to the recovery of $13,084.70, which had been paid to Allbritton by the workmen's compensation insurance carrier, and which Allbritton had sought to recover on its behalf. Though it was the real party in interest, with the right to sue therefor, it was not a party to this suit, having failed and refused to prosecute it against appellant. Instead, it sought to recover without suing by agreeing with appellee that, if he would bring the suit, he could recover, and hold for it, all sums that it was entitled to recover against defendant by virtue of its subrogation rights under the laws of Texas. Appellee accordingly prayed that he recover and hold said sums as trustee, but this he could not do. He was not the trustee of an express trust in the sense of Rule 17(a), which provides that every action shall be brought in the name of the real party in interest but that the trustee of an express trust may sue in his own name without joining with him the party for whose benefit the action is brought."

In *Gas Service Co. vs. Hunt* (10 Cir. 1950), 183 F. 2d 417, the court, in holding that insurance companies

which paid part of the loss should have been joined, distinguished the federal rule requiring joinder from the rule in some states permitting the insured to sue on the theory that he is a trustee for the insurer.

In any event, the plaintiff cannot maintain this action as trustee of an express trust. If any trust exists, it must arise by implication, because no trust is expressed in Exhibit B, the loan receipt. There is a vast difference between the loan receipt in this case and the one involved in *Dixey vs. Federal Compress & Warehouse Co.* (8 Cir. 1942), 143 F. 2d 275. This loan receipt does not require the plaintiff to bring any action on behalf of the insured; on the contrary it specifically assigns plaintiff's interest to Seaboard, and contemplates that Seaboard shall bring the action. The document in the *Dixey* case imposed upon plaintiff the duty to prosecute an action against the defendant, and to pay over to the insurer any sums so collected. We quote a portion of the document, which was reproduced in full in the *Dixey* opinion:

> "and we hereby agree to promptly present claim and, if necessary, to commence, enter into and prosecute suit against such person or persons, corporation or corporations, through whose negligence the aforesaid loss was caused, or who may otherwise be responsible therefor, with all due diligence, in our own name, but at the expense of and under the exclusive direction and control of the said Penn. Fire Insurance Company."

No such duty is imposed upon the plaintiff by the loan receipt agreement in this case. This document does not contemplate that the plaintiff shall prosecute any action. Any right of action existing in the plaintiff

is by the loan receipt fully and completely assigned to the surety company, which has succeeded to all of plaintiff's rights and duties in connection therewith. Consequently, no purpose could have been served by the creation of a trust and none was expressed.

III. THE AMENDED COMPLAINT FAILS TO STATE A CLAIM UPON WHICH EITHER McNEIL OF SEABOARD CAN RECOVER.

In its first order the district court refused to bring in the Seaboard Surety Company as an additional party plaintiff, because the complaint failed to state a claim upon which either McNeil or Seaboard could recover. We quote from the portion of the opinion covering this subject, appearing in the record at page 81:

> "The case of Meyers vs. Bank of American Nat. Trust & Savings Assn., 77 Pac. (2d) 1987, contains a thorough discussion of the problem of when a surety, who had paid a loss under a fidelity bond, is entitled to the benefit of subrogation, and an exhaustive analysis of the cases dealing with that subject. That case points out that a surety's right to recover by way of subrogation from a third person does not stand on the same footing as its right to recover from its principal; as to the latter, that right is absolute, as to the former it is conditional. It further points out that the doctrine of subrogation has with almost unanimity been held not to apply in favor of a surety on a fidelity bond, except only as against persons who participated in the wrongful act of the wrongdoer. The ultimate holding in Meyers vs. Bank of America is that in a case such as the one at bar, the surety who has paid the loss has no right by way of subrogation to proceed against the bank unless there are facts from which it appears that in equity and good conscience the bank rather than the surety should

stand the loss. This holding is supported by the great weight of authority, and what is more important here, this being a diversity case, it is the law in Montana as announced in American Bonding Co. vs. State Savings Bank, 47 Mont. 332, 133 Pac. 367.

Therefore, Seaboard Surety Company's right to maintain an action against the defendant bank under the doctrine of subrogation depends upon the existence of equities in its favor outweighing those in favor of the bank. The possibility that such equities may exist is suggested by evidence before the Court in the affidavits which might tend to show negligence on the bank's part in cashing and charging to McNeil's account 29 purported payroll checks payable to the same individual for the same payroll period. The Court is not now concerned with the questions of whether the bank's action in this respect amounted to negligence, and, if so, whether such negligence would constitute a sufficient equity in favor of Seaboard to entitle it to maintain an action against the bank under the doctrine of subrogation, however, because the complaint in this case contains no allegations of such negligence or of any other equities that might exist in Seaboard's favor. It is the action commenced by the complaint presently on file with which the Court is concerned, and from what has been said, it is apparent that Seaboard Surety Company is not the proper party plaintiff to that action, or otherwise stated, that the present complaint does not contain sufficient allegations to state a claim upon which Seaboard can recover. While Rules 19 and 21 of the Federal Rules of Civil Procedure authorize the Court to require the joinder of an indispensable party plaintiff in an action pending before it, they do not authorize the Court to require the joinder of a party in an action where the complaint does not state a claim upon which such party can possibly recover, and therefore defendant's motion to require the joind-

er of Seaboard Surety Company as a party plaintiff is denied."

In an attempt to circumvent the rules laid down in the cases cited by the court, the plaintiff filed its amended complaint in which it added allegations of negligence on the part of the bank. In its second order, the court dismissed the amended complaint on the ground that it also failed to state a claim upon which relief could be granted. The court's ruling in this respect is supported by ample authority in addition to the authorities cited in the opinion.

In the case of *American Alliance Insurance Co. vs. Capital National Bank* (1946), 75 Cal. App 2d 787, 171 P. 2d 449, *supra*, the plaintiff brought an action against the drawee bank to recover amounts paid on drafts presented by plaintiff's employee, upon which the employee had forged the names of the payees and appropriated the proceeds to his own use. Plaintiff was indemnified against the dishonest conduct of its employee by a surety company and was compensated for its loss by a loan receipt transaction identical to the one presented in this record. In the opinion at page 451, the court stated the respective contentions of the parties and its conclusion as follows:

> "The respondent contends that the receipt previously mentioned is a mere subterfuge on the part of the surety company, and that, properly construed in the light of the weight of authorities, it shows that plaintiff was fully compensated for its losses before the commencement of this suit and therefore has no valid cause of action against the bank, and that the surety company was not entitled to be subrogated to plaintiff's rights against the bank upon payment of its losses and therefore

has no right of action against the bank which it could have assigned to plaintiff or maintained in its own name.

The appellant contends that the surety company did not pay plaintiff its losses in satisfaction of its surety liability, but, on the contrary, that it merely loaned plaintiff the money which it paid, as the receipt therefor clearly indicates, and that said receipt authorized plaintiff sto, and it did, institute this action in behalf of the surety company.

We are of the opinion that, since the plaintiff was fully compensated for its loss on account of the forgeries of the drafts and the misappropriations of funds by Dietz before the commencement of the action, it could not maintain this suit in its own behalf, for to do so would result in plaintiff's receiving double pay for its losses, and that it could not maintain the action in behalf of the surety company, the indemnitor of plaintiff, since it was not entitled to be subrogated to the right of plaintiff. Meyers vs. Bank of America, etc., Ass'n., 11 Cal. 2d 92, 77 P. 2d 1084."

The court then discussed the case of *Meyers vs. Bank of America* (1938), 11 Cal. 2d 92, 77 P. 2d 1084, to show that a surety company which pays a forgery loss has no right to subrogation entitling it to recover against the drawee bank. In doing so, the court stated at page 452:

"The decision in the Meyers case further quotes with approval from First & Tri State Nat. Bank & Trust Co. v. Massachusetts Bonding & Ins. Co., 102 Ind. App. 361, 200 N.E. 449, as follows: 'The doctrine of (subrogation) has been applied most frequently in the courts to certain types of insurance cases. It has with almost unanimity been held not to apply *in favor of a surety on a fidelity bond*, except only against persons who partici-

> pated in the wrongful act of the wrongdoer. (Citing numerous authorities.)' "

The court then concluded that the surety company had actually paid the plaintiff and that consequently plaintiff had no right of action. If further held that the plaintiff had no standing to contend that it sued as an assignee for collection, and in that connection it made the following important statement at page 454:

> "We are of the opinion that receipt of said money by plaintiff was in payment of the surety company's bonded liability in discharge of its indebtedness, and not as a mere loan. *If it was not a payment of the liability the surety company would not be entitled to subrogation and it therefore had no cause of action which could be assigned to plaintiff for collection, as we have previously held.*"

The fact that the form of plaintiff's compensation is immaterial for the purpose of this rule was more vividly demonstrated in the case of *Hensley-Johnson Motors vs. Citizens National Bank* (1953), 122 Cal. App. 2d 22, 264 P. 2d 973. This also was an action by a depositor to recover from the drawee bank for the amount of unauthorized checks cashed by one of its employees. Fireman's Fund Indemnity Company, the surety, paid the plaintiff \$1,378.64 for certain losses and agreed to pay the plaintiff \$1,285.24 on other losses with the understanding that the latter sum would be paid by it to plaintiff in the event the latter failed to recover it in an action against the defendant. The court held that the plaintiff, by reason of its agreement with Fireman's Fund, had made an election of remedies and thus could not recover against the drawee

bank. The opinion contains the following statements:

"As to the losses after August 2, when the amount of the bond was $10,000, defendant argues that since plaintiff received $1,378.64 from Fireman's Fund on account of such losses and an agreement by the latter to reimburse it for the balance of the loss after that date should plaintiff not recover such balance in an action against defendant, it was reimbursed in full and plaintiff may not recover the loss after August 2 from it. Plaintiff argues it has a legal right to collect the balance of the loss after August 2, irrespective of its agreement with Fireman's Fund.

Plaintiff's right to recover the amount of the checks cashed after August 2, 1950, depends on the legal effect of its acceptance of $1,378.64 from Fireman's Fund to apply on losses which occurred after that date and the agreement of the latter to pay plaintiff $1,285.24, the total of the two checks cased after August 2 less the amount deposited by Marchand in the Bellflower bank, in the event plaintiff failed to recover that sum in an action against defendant.

There are two independent contracts involved: one, between plaintiff and defendant by which the latter agreed it would not pay the checks of plaintiff on forged endorsements, the other, between plaintiff and Fireman's Fund by which the latter agreed to reimburse plaintiff for its losses. Both remedies were open to plaintiff with the limitation that there could be but one satisfaction.

Meyers v. Bank of America, etc., Ass'n., 11 Cal. 2d 92, 77 P. 2d 1084, holds that where an employer has sustained loss as a result of his employee's forging endorsements on checks, and the employer's surety has reimbursed him in full for the loss, the surety cannot recover from the bank since the surety has no equities superior to those of the bank. See 27 Cal. L. Rev. 88.

A number of cases hold that a bank depositer who claims that a bank has paid out his money to

a person not entitled to receive it has an election to sue either the bank or the person who received the money but that, if he chooses to sue the latter, he thereby precludes himself from suing the bank. See annotation 144, A.L.R. 1440. No Dust O Co. v. Home Trust Co., Mo. App., 46 S.W. 2d 203, 207, was an action by a depositor against a bank for the aggregate of checks wrongfully cashed by its employee. The depositor-employer accepted a note and mortgage from a relative of the employee in full payment of his shortages. The court held that by accepting the note and mortgage the employer ratified the employee's 'act in cashing the checks in question at the defendant bank', citing Cushman v. Loker, 2 Mass. 106; Lafitte, Dufilho & Co. v. Godchaux, 35 La. Ann. 1161; Ogden v. Marchand, 29 La. Ann. 61; Glor v. Kelly, 49 App. Div. 617, 63 N.Y.S. 339; McCoy v. Simon, 64 Wash. 574, 117 P. 400; Crute v. Burch, 154 Mo. App. 480, 482, 135 S.W. 1004; Lokey v. Rudy-Patrick Seed Co., Mo. App., 285 S. W. 1028."

And at page 978 in the opinion, the court stated:

"The effect of the agreement between plaintiff and Fireman's Fund is that plaintiff has been reimbursed in full by the surety for the losses sustained after August 2. Plaintiff, by accepting payment of $1,378.64 from Fireman's Fund, together with its agreement to reimburse it in full, treated the money paid out after August 2 as belonging to it (plaintiff). Having treated the money as its own and having secured the agreement from the surety, it will not now be allowed to reverse its position and say the money is still in the bank. When plaintiff accepted the agreement from the surety, it waived its claim against defendant."

Another case which was cited in the *Hensley-Johnson* case, and which is directly in point, is *Liberty Mutual Insurance Co. vs. First National Bank* (Tex. Civ. App. 1951), 239 S.W. 2d 738. In that case an employee

obtained payment of checks from the drawee bank on forged endorsements. The employer recovered the defalcations from the surety on the employee's fidelity bond. The employer and the surety executed a written instrument which declared that the payment for the defalcations was an advance and that the employer would prosecute a claim against the bank and pay over such money as it recovered to the surety. The court held that the plaintiff had elected to proceed against the surety and that it had no standing in an action against the bank. The opinion stated:

> "Possibly in an effort to avoid the effect of an election of remedies, appellant and the fidelity insurer executed an instrument in writing, at the time the claim on the bond was paid, which declared that the sum involved was being advanced to appellant, and that appellant would prosecute a claim against the bank at the cost and expense of the fidelity insurer, and would pay over to the latter such money as it might recover from the bank.
>
> We are not able to see that the language of this writing changed either the form or the substance of what was done by way of making claim on the fidelity bond. It is undisputed that claim was made on the bond, and that the full amount of the defalcations was paid to appellant. Appellant elected as to the remedy it would pursue, and prosecuted the claim on the fidelity bond to a successful conclusion. To call this transaction a loan would be to ignore the realities of the situation. If, as we have held, the doctrine of election of remedies is applicable to the case, the result is that appellant waived its claim against the bank, and had no claim against the bank which it could thereafter prosecute on behalf of the fidelity insurer, or assign to it."

As is pointed out in all of these cases, it makes no difference whether plaintiff claims to be suing for his own account or as a trustee or assignee for collection. He is barred from an action on the former theory under the doctrine of election of remedies, and he has no standing to sue as an assignee for collection because the surety had no right of subrogation and therefore had no claim against the defendant which it could assign to the plaintiff.

For other cases in point, see *National Surety Company vs. Perth Amboy Trust Co.* (3 *Cir.* 1935), 76 F. 2d 87; and *Midland Savings & Loan Co. vs. Trademen's National Bank* (10 Cir. 1932), 57 F. 2d 686, where it was held that a depositor could not recover against the drawee bank amounts paid on forged endorsements, where it had previously recovered from its surety company.

It is clear that the amended complaint is not framed for the purpose of enforcing an alleged right of subrogation on behalf of Seaboard Surety Company. The alleged right of Seaboard to be subrogated to the rights of plaintiff is nowhere alleged or asserted, and there is no prayer for such relief in the amended complaint. Although the plaintiff has attempted to allege negligence on the part of the defendant, it has failed to assert a claim for subrogation on the basis of such negligence. Furthermore, it has not alleged the existence of equities in favor of Seaboard Surety Company outweighing those of the bank. The district court's order expressly stated that such allegations are a necessary part of Seaboard's action. The following statement appears

in 50 Am. Jur., *Subrogation*, Section 145, at page 774:

> "Ordinarily, subrogation, whether sought by the plaintiff or the defendant, must be pleaded, and the facts out of which the right of subrogation arises must be set forth and proved."

Similar comments are made in 83 C.J.S., *Subrogation*, Section 63, as follows:

> "The doctrine of subrogation is not self-executing, and a person by payment does not ipso facto become subrogated to the rights of the creditor; he acquires only a right to a subrogation which must be actively asserted before subrogation can actually take place. The right of substitution and the intention, express or implied, to enforce the right must concur to make a case for subrogation.
>
> Subrogation is a right of action only which must be established by a judicial proceeding in which two distinct sets of facts are involved, that is, those which show the right to be subrogated and those which show that the claim to which subrogation is had may be enforced against the principal."

In any event it would be futile for the Seaboard Surety Company to attempt to assert a right of subrogation against the bank in this case, because McNeil Construction Company has no cause of action to which the surety can become subrogated. This is so because McNeil proceeded against the forger (through his surety) and recovered from that source before proceeding against the bank. As the district court pointed out in its order, the surety company stands in an entirely different position in this case as distinguished from a case where it is suing the principal debtor. The court observed the fact that the doctrine of subrogation has with almost unanimity been held not to apply in favor

of a surety on a fidelity bond, except only as against persons who participated in the wrongful act of the wrongdoer. The reasons for this are obvious: the surety company undertook for profit to guarantee the acts and doings of the very person who caused the loss; furthermore, there is available to it, under a proper application of the doctrine of subrogation, an action against the wrongdoer.

Here it is not even intimated that the bank participated in the wrongful act of the employee who forged the checks. The action is based upon an alleged right of McNeil Construction Company to recover for negligence of the bank in honoring the forged checks. Any right of action which McNeil might have had on this theory has been extinguished by virtue of McNeil's election to proceed against the surety, and by payment in full. Since McNeil has no action against the bank in its own behalf, there is nothing to which Seaboard Surety can become subrogated.

IV. CONCLUSION

In conclusion, we submit that the Order and Judgment of the district court should be affirmed for the following reasons:

1. Appellant has no standing to complain of any alleged error committed by the court prior to the time that appellant voluntarily filed its amended complaint.

2. The district court's interpretation of Montana law, on the question whether the loan receipt constituted payment, should be upheld because it is not mani-

festly contrary to any decisions of the Montana supreme court.

3. Appellant is not the real party in interest and may not maintain this action on the theory that it is the trustee of an express trust.

4. The amended complaint does not state a claim upon which either the appellant or Seaboard Surety Company can recover.

Respectfully submitted,

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